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Paper 10-03
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Exposure Draft
Equity Method of Accounting, IAS 28 *Investments in Associates and Joint Ventures* (revised 202x)

Feedback received so far

TOPICS	**STAKEHOLDER FEEDBACK**
GENERAL COMMENTS	
Approach to project	IAWG- 12 May 2022 It was clarified that the IASB decisions should rather not change the accounting approach when the classification of investment changes from associate to joint venture and vice versa. FIWG- 21 June 2022 The equity method cannot be fixed by tweaking some elements of it. It is still perceived by some as valuation method and by others as small consolidation. Feedback in NSS meetings where EFRAG is participating (e.g., ASAF, WSS) ASAF (July 2023)- A majority of members supported the issuance of an exposure draft of amendments to IAS 28 (rather than an exposure draft of IAS 28 revised; as this would better reflect the project objective to answer identified application questions applying core principles that already exist in the Standards; but not change those principles. Issuing amendments to IAS 28 would also be less disruptive for stakeholders and imply less cost and efforts from the IASB. Some members also emphasised that the consequential amendments to other standard should be carefully considered (in particular IAS 27 Separate Financial Statements).

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<tr><td></td><td></td></tr>
<tr><td colspan="2">SPECIFIC APPLICATION CHALLENGES ADDRESSED IN ED</td></tr>
<tr><td><u>Change in ownership: Obtaining significant influence or joint control</u>

ED proposal- Measure cost at the fair value of the consideration transferred, including the fair value of any previously held ownership interest.</td><td><u>FIWG- 21 June 2022</u>

The tentative decision to require fair valuation of the previous interest when obtaining significant influence is conceptually consistent with accounting for business combination when obtaining control.

<u>UP 7 July 2022</u>

Views were sought on the following three options:

• Approach A - continue to measure the investment as a single asset; the approach would remeasure both the investor’s share of the associate’s net assets at fair value and measure the aggregate cost of the investment at fair value at the date of acquiring the additional interest.

• Approach B - measure the interest as an accumulation of purchases. The investor would recognise its additional share of the associate’s net assets with the cost (being the fair value of the consideration transferred) for the additional interest.

• Approach C - continue to measure the interest as a single asset but based on the investor’s share of the associate’s net assets at their carrying amounts for the investment, with the cost (being the fair value of the consideration transferred) for the additional interest.

User panel members supported Approach A. However, they noted there could be major conflicts and governance issue associated with this approach and they called for more/better disclosure on the associates P&L and cashflow.</td></tr>
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Change in ownership: Purchasing an additional interest while retaining significant influence ED proposal: Add, to the carrying amount of the investment, the additional share of the fair value of the identifiable assets and liabilities at the date of purchase. Account for any difference between the fair value of consideration transferred and the additional share of the fair value identifiable assets and liabilities either: • as goodwill (included in carrying amount of the investment); or • as a gain from bargain purchase in profit or loss.	FR TEG 4 June 2024 Some members commented on the complexity of the layer approach (ex. step-up issues). FR TEG 6 June 2023 Members generally considered that the tentative decisions taken were not expected to be controversial, provided practical solutions to identified issues and were generally consistent with current practice and/or existing literature. They considered it will nevertheless be important to see the exact wording of the amendments to form a final view in particular to: a) understand how the proposals are justified from a conceptual standpoint in the basis for conclusions; b) ensure that they do not result in excessive requirements for preparers; in particular to perform a full 'purchase price allocation' exercise for any purchase of additional interest in an associate while retaining significant influence. FR TEG 29 June 2024 Approach B (layer approach) was the most common approach. IAWG 28 May 2024 Complexity of the accounting requirements related to the subsequent acquisitions and increases of ownership interest, which will be very burdensome and costly for the preparers. Members questioned the proposals related to the partial disposal of ownership while retaining significant influence. They noted the inconsistency between the layered approach for the acquisition of additional shares while retaining significant

	influence versus the single unit of account for the partial disposal of ownership interest. This inconsistency may distort the result analysis. <u>FIWG 13 June 2024</u> A member noted that the tentative decisions related to the accounting for acquisition of additional shares while retaining significant influence is resulting in a significant complexity for the parent company that has investments in equity-accounted investees, requiring them to perform a purchase price allocation exercise at every acquisition. On the other hand, a member representative of the user community, noted that the proposed approach would provide a much-needed information to investors and would better align with the economic reality of the transactions. <u>IAWG 12 June 2022</u> Step acquisitions and remeasuring is not problematic compared to aligning the accounting policies with an associate for reporting purposes and disclosing the information about the associate in investor's accounts. The groups may prefer not to revalue the previous holding when additional shares are purchased because it does not have economic relevance. The requirements in IAS 28 regarding step acquisitions should be consistent with an accounting approach explained by the IFRS Interpretation Committee on step-by-step acquisitions of a subsidiary in separate financial statements. <u>FIWG 21 June 2022</u> Approach B, which requires accounting for layers of the investment, is conceptually consistent with the equity method itself, because it's not a full consolidation but rather accounting for acquired share of assets, profits. Approach A, in turn, would actually be somewhere between the fair valuation and the equity method. The risks associated with the method include valuation of acquired shares of non-listed entities. Furthermore, affecting the

	valuation of entire shareholding may result in the entities doing some P&L management through small acquisitions. If such an approach is chosen, then it actually would be more feasible to use fair value method instead. <u>UP 27 June 2024</u> In relation to the proposed layered approach upon the acquisition of an additional shareholding interest in an investee while retaining the significant influence, several UP members questioned the reason for restricting the fair value measurement to the incremental acquired interest as opposed to the investment as a whole. They noted that users are ultimately interested in knowing the fair value of an investee. In line with the above observation, members discussed the possibility to use the last transaction price (the price for the latest layer acquired) as a proxy for the fair value of the investment and usefulness of disclosing the said last transaction price. It was however noted that if the last transaction took place at a date different from the reporting date, such an amount might not provide relevant information for the users of the financial statements. On the other hand, some members noted that revaluing at fair value the investment as a whole may create earnings management opportunities for an investor entity. For instance, by acquiring additional minor interest while retaining significant influence only for the purpose of revaluing the investment as a whole. Further, it was noted that management is responsible for the invested capital and not for the fair value of a non-controlled investee and therefore the equity method is better suited for this purpose. These members emphasised it is the analyst’s job to determine the fair value of the investee entities while valuing the reporting entity. The considerations expressed by these members were in support of the equity method of accounting as opposed to fair value through PL measurement.

Change in ownership: Partial disposal of ownership while retaining significant influence ED Proposal: Measure the disposed portion as a percentage of the carrying amount of the investment at the date of disposal. Recognise the difference between the consideration received and the disposed portion as a gain or loss in profit or loss.	IAWG 28 May 2024 Complexity of the accounting requirements related to the subsequent acquisitions and increases of ownership interest, which will be very burdensome and costly for the preparers. Members questioned the proposals related to the partial disposal of ownership while retaining significant influence. They noted the inconsistency between the layered approach for the acquisition of additional shares while retaining significant influence versus the single unit of account for the partial disposal of ownership interest. This inconsistency may distort the result analysis. FR TEG 29 June 2022 Weighted average approach to partial derecognition, compared to LIFO approach, was a preferred approach. FIWG 22 June 2022 Accounting for disposals and which method of allocation to use is not a brand-new issue and FIFO or weighted average methodologies were used. The weighted average for identification of cost of sold shares is preferred. It will minimise the P&L volatility and may be perceived as less biased. The logic of Approach B fits into the mechanics of equity method itself, but it is not clear whether it provides relevant information. Furthermore, before putting LIFO/ FIFO requirement in IAS 28, a weighted average approach should be considered.

Other changes in ownership (e.g., via associate issuance or redemption of its shares) ED proposal: Account for the change as if purchasing or disposing of an ownership interest.	
Change in ownership: Deferred tax effects ED proposal: On obtaining significant influence or joint control, include in the carrying amount of the investment the deferred tax effects.	FR TEG 6 June 2023 Members generally considered that the tentative decision taken was not expected to be controversial, provided practical solutions to identified issues and were generally consistent with current practice and/or existing literature.
Change in ownership: Contingent consideration ED proposal: On obtaining significant influence or joint control, recognise contingent consideration as part of the consideration transferred and measure it at fair value.	FIWG 13 June 2024 A concern was raised by one member in relation to contingent consideration being measured at fair value. It was noted that the equity method was, in essence, a cost measurement method, however, based on the proposed amendments, it was leaning more and more towards fair value measurement.
Share of profit and loss and OCI when the associate's losses exceed carrying value How does an investor or joint venturer recognise its share of profit or loss and other comprehensive income: • if its share of profit or loss and its share of other comprehensive income are both losses that equal or exceed its net investment?	

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- if its net investment has been reduced to nil and if either its share of profit or loss or its share of other comprehensive income is a profit?

ED Proposal: The investor or joint venturer would:
- recognise its share of profit or loss and then its share of other comprehensive income.
- recognise separately its share of profit or loss and its share of other comprehensive income.

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<u>Transactions with associates and joint ventures</u>

How does an investor or joint venturer recognise gains or losses that arise from the sale of a subsidiary to its associate or joint venture, applying the requirements in IFRS 10 *Consolidated Financial Statements* and IAS 28?

ED Proposal: Recognise the full gains or losses from all transactions with its associates or joint ventures.

The existing requirement in IAS 28 is to recognise gains or losses to the extent of unrelated investors' interests in the associate (for instance, an investor with a 25% ownership interest recognises 75% of gains or losses). The proposed amendment changes that requirement to require recognising full gains or losses.

The proposed amendment withdraws the amendments to IAS 28 and IFRS 10 issued in 2014, that were indefinitely deferred.

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<u>FIWG 13 June 2024</u>

Some members welcomed the tentative decision related to the accounting of the full gain or loss on the transactions with equity-method-accounted-for subsidiaries.

<u>IAWG- 28 May 2024</u>

Member/s challenged the consistency of the tentative decisions with IFRS 10 and the concept of control used in IFRS 10 and IAS 28.

<u>FR TEG 6 June 2023</u>

Members generally considered that the tentative decisions taken were not expected to be controversial, provided practical solutions to identified issues and were generally consistent with current practice and/or existing literature. They considered it will nevertheless be important to see the exact wording of the amendments to form a final view in particular to understand how the proposals are justified from a conceptual standpoint in the basis for conclusions.

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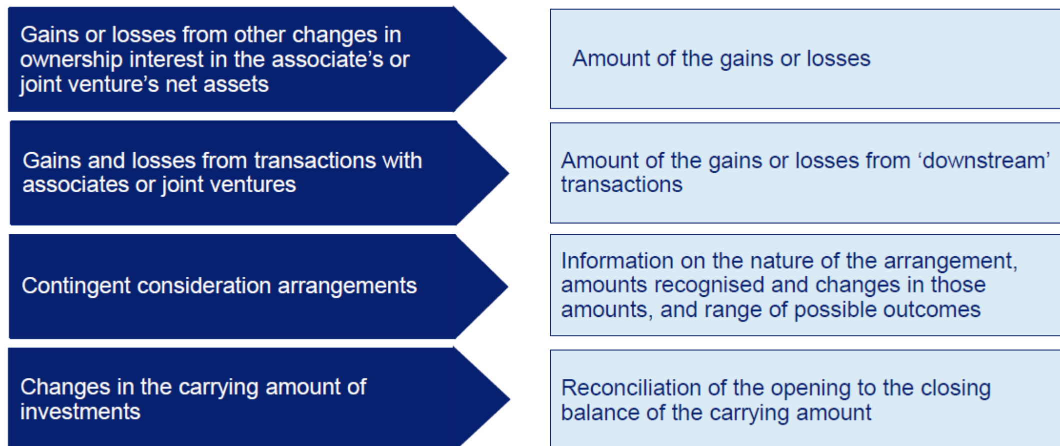
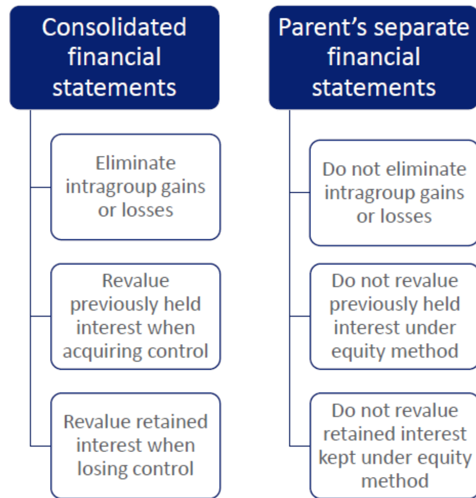
	Transactions with joint ventures and subsidiaries accounted for under the equity method in Separate Financial Statements may raise specific and distinct issues that need to be considered carefully (e.g., the risk of earnings management in presence of (joint) control). <u>FIWG 22 November 2022</u> EFRAG FIWG discussed four alternative approaches (Alternative 1 (no elimination of gains or losses), Alternative 2 (full proportional elimination of gains or losses), Alternative 3 (mixture dependent upon facts and circumstances including, transaction of business/entity or asset and ordinary activity or not), and Alternative 4 (revival of 2014 amendment) for accounting for a transfer of business or assets from investor to its associate. The members expressed their mixed preference: (a) One member preferred Alternative 4 – due to its consistency with the principle regarding loss of control over business, it also was important to keep the equity method as a partial consolidation with elimination of “intra-group” transactions. In his opinion, otherwise, accounting for associates could just switch to fair value. (b) One member noted that while Alternative 4 sounded sensible this member could not see the conceptual basis for Alternative 3. (c) One member agreed that Alternative 3 lacks the conceptual basis, and believed that due to necessary judgment, it would be the most complex to apply. Instead, he preferred the original 2014 amendments and consequently, Alternative 4. Moreover, he noted that without defining what Equity Method should portray it is difficult to assess whether these alternatives provide faithful representation. Considering simplicity, he preferred Approach 1

	and 2 and therefore he believed that it should be a policy choice between Approach 1 and 2. (d) One member explained that there may be a need for a policy choice because the scoped issues comprise accounting for different assets. There is a need for consistent method but also a need to faithfully portray the transactions. (e) Another member always struggled with eliminations because when investor has significant influence, it does not have access to the same level of information compared to controlled entity. Therefore, this member would rather prefer full recognition scenarios (Alternative 1). However, this would require a more profound change than just resolving the contradiction between IFRS 10 and IAS 28. Feedback in NSS meetings where EFRAG is participating (e.g., ASAF, WSS) ASAF-Septemer 2023- There is no presumption that, in joint venture arrangements, transactions are done on an arms-length basis and consequently, some "earning opportunities" may arise. Although IAS 24 *Related Parties Disclosures* requires disclosing some information, this could be a topic to be raised when the IASB publishes its Exposure Draft in order to get the robust disclosures around such transactions.
Impairment indicators Does an investor or joint ventures assess a decline in the fair value of the net investment by comparing the fair value to the original purchase cost or the carrying amount at the reporting date? ED proposal: Compare the fair value to the carrying amount of the investment at the reporting date. The IASB is also proposing:	FR TEG 29 June 2022 Bargain purchase should be considered as impairment indicator

• to remove the reference to 'a significant or prolonged' decline in the fair value of an investment. • to change some of the wording in IAS 28 on impairment indicators to align with IAS 36. The proposed amendment does not change the requirements in IAS 36 *Impairment of Assets* on how an entity measures the recoverable amount of the net investment.	
<u>Improved disclosure requirements for associates</u> ED Proposed Disclosures  	<u>UP 27 June 2024</u> A majority of the members welcomed the proposed requirement to disclose the reconciliation between the opening and closing carrying amount of the equity-accounted-for investments, noting, however, the importance of specifying the granularity of the information to be provided. For example, users highlighted that the information disclosed should allow them to understand inflows and outflows of an equity-accounted-for investee, such as the investor's share of profit or loss, dividends distributed and other information useful for the estimation of the investee's fair value.

<u>Separate financial statements</u>  ED Proposal: The IASB decided its proposed answers to the application questions would also apply to a parent that chooses to use the equity method to account for its investments in subsidiaries in its separate financial statements.	<u>FR TEG 6 June 2023</u> Transactions with joint ventures and subsidiaries accounted for under the equity method in Separate Financial Statements may raise specific and distinct issues that need to be considered carefully (e.g., the risk of earnings management in presence of (joint) control). <u>FR TEG 29 June 2022</u> The application of equity method to subsidiaries in separate financial statements should also be considered. <u>Feedback in NSS meetings where EFRAG is participating (e.g., ASAF, WSS)</u> ASAF- September 2023- Accounting for acquisitions of, or loss of control should be considered in a project where equity method is applicable to subsidiaries in separate financial statements. Furthermore, a cost model applicable to subsidiaries in separate financial statements should also be considered and clarified in the light of amendments to the equity method. In some European jurisdictions, the separate financial statements are covered by local GAAPs, and some local GAAPs already require applying the alternative (i.e. restricting some gains/losses) for separate financial statements.

Transitional requirements	Feedback from preparer outreach
Apply the proposals **prospectively**, except, at transition date, recognise: • any previously restricted portion of gains or losses from transactions with associates or joint ventures in retained earnings; and • contingent consideration at fair value as an adjustment to the carrying amount of the investment.	One preparer considered that 'partial gain' accounting policy is preferable because it provides a better correlation between the profit or loss and the cash flows of each period. In the event that the IASB decides to continue with the current proposals, the Board should consider proposing a prospective initial application for all adjustments of the Equity Method Project. Alternatively, the Board may consider including an exemption to retrospective initial application of the 'full gain" accounting policy for transactions between an investor and its associate or joint venture that implies an excessive complexity (i.e. retrospective accounting of a net investment in a foreign operation or past transactions executed beyond more than one year before the initial application).
Interaction with other IFRS Standards (IFRS 18)	FR TEG- 4 June 2024 One member raised a comment related to the scope of IAS 28 specifically in light of IFRS 18 Standard, providing the companies with an option to reassess the requirements of IAS 28 upon transition and potentially apply fair-value measurement under IFRS 9 instead of IAS 28 for certain JV and subsidiaries, if applicable. IAWG 28 May 2024 Interaction with IFRS 18 allowing the companies to reassess the application of the equity method upon transition with a possible change to fair value through PL, noting that the current requirements in IAS 28 were not clear as it relates to the scope of the equity method. Members suggested raising this concern as part of the comments to the upcoming ED and as part of the suggestions for the annual improvements exercise by the IASB.